Motives for Barter: A Literature Review

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Abstract
Barter is not something that was present only before invention of money. Even Fortune 500 companies are involved in barter. The most common bartered goods and services are media and travel. As the amount of barter increases even in the U.S., it is worth investigating the reasons why organizations use barter. The paper provides a literature review of barter motives digested from academic journal articles covered in the Web of Science and EBSCO databases. The review includes also drivers that are specific for developing countries.

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1. Introduction

Although bartering is often described as a process, in which goods and/or services are directly exchanged for other goods and/or services without a common unit of exchange (without the use of money), this paper will not follow this narrow definition. There is no obvious reason why some kind of value could not be attributed to bartered goods and services. The assigned value may be linked to a common denominator that would serve as exchange media, such as length of work, or an existing currency.

This paper will primarily focus on barter between organizations. According to Cresti (2005), there exist two forms of barter:

- Corporate barter. Corporate barter companies (kind of brokerage houses) help large companies to exchange their products; trades often require part of the settlement in cash.
- Retail barter. Barter networks (barter clubs/trade exchanges) coordinate barter trade among their members – predominantly small and medium enterprises.

This paper will consider also barter between two or more companies without involvement of any brokerage houses or exchanges. Moreover, the term countertrade appearing in the reviewed papers will be considered to be barter as long as it involves organizations, not countries.

The literature review is based on academic papers accessible through the Web of Science and EBSCO databases. The main reason for including also EBSCO papers was the fact that there were only a few relevant papers in the Web of Science database. The search query used for both Web of Science and EBSCO databases was

barter AND (motiv OR reason OR driv*)*

The motivation for the search term was to find motives, reason, and drivers for barter regardless whether this meaning would be expressed as a noun or a verb. This query was used to search for a particular topic (i.e. to consider titles, abstracts, key words, references; not full text) in the Web of Science database and through all text (i.e. titles, abstracts, key words, references, and full text) in the EBSCO database. The reason for difference in treating the databases is that Web of Science does not provide a possibility to include full text.

2. Motivation

The motivation for paper stems from the fact the there are not too many papers investigating barter per se. Even fewer focus on inter-organizational barter, and only some of them actually discuss motives of organizations to participate in barter. An obvious motive for barter is inflation. And due to quantitative easing, rising inflation is a real threat. Another driver for investigating the motives for barter is the soaring price of the International Monetary Systems (ticker OTC: ITNM), a U.S-based barter exchange. The development of its share price is provided in Figure 1.

Figure 1: Share Price Development of the International Monetary Systems

Source: Google Finance

Only organizations (including sole entrepreneurs), not individuals, can trade on the barter exchange. So the soaring price indicates that there are still more and more organizations interested in barter.

3. Literature review

There were three papers that investigated barter motives using quantitative methods. Surprisingly, all of them were publishing almost at the same time – about 15 years ago.

Damitio and Schmidgall (1995) were interested in barter in tourism; they specifically focused on the lodging industry. They found that the retention of cash was the major reason for bartering. Another driver for bartering was to dispose of surplus inventory. The last but not least motive was a possibility to obtain advertising at a lower cost than if they had to pay for it in cash.

Paun and Shoham (1996) discussed the following reasons for inter-organizational barter: establishing relationships with new trading partners, allowing for entry to new or difficult markets, generating goodwill, accessing marketing networks and expertise, disposing of surplus products, using excess production capacity, disposing of obsolete or perishable products, increasing sales volume, increasing profits, enhancing competitiveness, and securing government contracts.

Palia and Liesch (1997) talked about countertrade but their motives are applicable for inter-organizational barter: developing new markets, increasing sales potential, increasing growth of sales potential, building long-term strategic alliances, strengthening competitive position, increasing market share potential, developing markets for new products/services, increasing profit potential, fulfilling buyer requirement, improving cost position (scale economies), repatriating funds, building political capital, disposing of countertraded goods, and acquiring countertraded goods.

Remaining papers were theoretical, conceptual or used qualitative research methods. Many of them mentioned inflation as the reason, e.g. (Banerjee and Maskin, 1996; Gumbe and Kaseke, 2011). Marvasti and Smyth (1998) stated that primary reasons for international barter are hyperinflation, trade restrictions, and foreign exchange problems citing Huh (1983) and Banks (1985).

According to Marvasti and Smyth (1998), domestic barter usually flourishes during economic downturns because companies use barter to reduce their excess inventory instead of the alternative of selling the product to liquidators at less than wholesale prices. Another reason is to restrain price increases by vendors during inflationary periods. In this case, companies use long-term barter contracts where the price of the goods to be received is specified as a ratio of exchange for the good to be delivered. Companies may also use barter as a supplement to money transactions. Here, companies may use their purchasing power as a lever or a marketing tool to gain entry into new markets.

Tax evasion or avoidance was another often cited motive (Marvasti and Smyth, 1998; Schneider, 2010). Yakovlev (2000) mentions lack of a competitive monetary system besides tax evasion as the major reason for barter.

Goorha (2001) talks about a different distortion of the free market – subsidies. The firm being subsidized understandably has the incentive to scale back production and earn a supernormal rate of return on the reduced quantity of output. However, this defeats the original purpose of maintaining a politically or socially desirable level of output. A system of barter, by which downstream firms pay upstream firms in kind, reduces this problem by providing a system of verification. Upstream firms will potentially be willing to accept payments in kind for two reasons. First, if they are primarily the subsidizers, then such 'quantity verification' is required essentially to ensure they are receiving what they paid for, i.e. political support through employment. Second, if subsidies are being channeled through them by some external source, then barter provides a mechanism for sharing in the economic profit of the downstream firm, especially since the relative price of the barterable good is largely negotiable. Subsidies can be redirected to the upstream firm if it agrees to accept worthless goods (since quality is not being verified) or simply report an exaggerated quantity. The former provides some support for the fact that positive growth was achieved at the height of barter (Shleifer and Treisman, 2000).

Some researchers mention quality as one of the issues in bartering. Quality is usually unknown. Li (1998) argues that this makes an intermediary, who checks the quality of the bartered goods, a useful extension of the barter relationship. Fong and Szentes (2005) point out that there is no inherent intention to increase quality in bartered goods.

Neale, Shipley and Sercu (1992) talk about countertrade in a way that is applicable to barter. They state that countertrade enables importing companies to circumvent hard currency and credit difficulties; to access Western markets more easily by penetrating marketing channels and overcoming other entry barriers such as adverse country-of-origin stereotypes and high distribution costs; and to disguise dumping, to offload low quality products and to shift goods in world excess supply (Cohen and Zysman, 1986; Jones 1990; Kaikati 1981; Nykryn 1985; Okoroafo 1988; Weigand 1980; Yoffie 1984;). Accepting demands for countertrade enables the Western exporter to gain volume when sales are sluggish so as to fill out under-utilized capacity and meet contribution targets.

Some proponents of countertrade have argued that it can be a preferential mechanism to conventional transacting. Mirus and Yeung (1986) consider barter more efficient than the same transaction conducted in terms of money if it saves search and transactions costs. They see countertrade as an exchange of bundled goods and services according to competitive advantage: the exporter receives a product plus reduced uncertainty regarding future market access, while the importer receives a bundle of product and service benefits. The exporter benefits whenever the gain (net of marketing costs) from the goods accepted plus the long term benefit of more certain market access exceeds the cost of its exports. In this respect, countertrade is a rational response to uncertainty and differential transaction costs.

Countertrade can also generate economies of time since it enables exporters to avoid delays resulting from currency rationing regimes by an importer's government. Kogut (1986) depicts countertrade as a form of internalization whereby large diversified multinational corporations can source raw materials and components via countertrade if the terms surpass the stated offers met from current vendors. This company-to-company trade meets the needs of each counterparty and saves on distribution costs, achieving better terms of trade than in the open market.

Noguera and Linz (2006) mention several motives. One is to conserve cash (e.g. for investment in short-term government debt instruments. The second is to avoid the high cost of acquiring debt. Here it is possible to remind that even firms that switch into barter would still prefer to receive payments in cash, if possible (Commander and Mummsen, 2000; Commander et al., 2002; Krueger and Linz, 2001).

Lindberg (2002) points out that there are also other reasons to engage in nonmonetary exchanges, such as barter, and thus avoid cash transactions. For instance, Gaddy and Ickes (1998, p.

60) note that “[t]he tax authorities might be less likely to accept noncash payments from an enterprise holding a lot of cash. Cash is also vulnerable to extortion by organized crime”.

There are several reasons espoused for the continued prevalence of barter in Russia, including the liquidity squeeze due to tight economic policy, the avoidance of paying taxes in full, and the claim that Russian managers use barter transactions to divert profits and delay restructuring of enterprises (Guriev and Kvassov 2000).

According to Bowen, Davis and Rajgopal (2002), it appears that firms reporting barter revenue are more likely to enter into marketing and content alliances, suggesting that the potential for future alliances may be another motivation for managers to enter into barter transactions.

At the end, I would like to cite the oldest reviewed paper, by Weigand (1979), in order to demonstrate that most of the motives for barter were identified more than three decades ago. He cites the following “reasons [that] account for the popularity of these practices:

• No balance of payments deficits, no hard currency shortages. Balance of payments on the current account is thrown into an imbalance when countries buy more than they sell during a particular fiscal period. Bilateral balancing of the current account is assured when countries barter because exports equal imports, even in the short run. Balancing takes a few years longer when compensation arrangements are worked out, but the import of technology and know-how is matched by the subsequent export of their end product. Many east European and developing countries have had serious payments difficulties recently and do not have the hard currency to get out of their problem. Noncurrency transactions reduce this phenomenon.

• End result is "extra sales." Nonmarket countries sometimes view nonmoney transactions as incremental sales. Such transactions involve goods that find a separate market not previously tapped. Government trading offices regularly are looking for markets never before receptive to their products. One way of gaining access to these virgin customers, the government bureaucrats believe, is to buy something those prospective customers hope to sell. Coffee-growing countries sometimes enter into barter arrangements with countries that are essentially tea-drinking in the hope of winning converts. Barter is viewed as a way of priming the market.

• Poor quality goods are unloaded. Most countries sell their best goods for cash. Some poor quality merchandise is sold in the home market but the balance must be exported. If it cannot be readily sold for hard currency, the foreign trade organization in the export-minded country may offer to take western goods rather than hard currency as an inducement.

• Dumping and discounting are disguised. As was pointed out earlier, barter may be used to muddy the selling price of a product. No seller, eastern or western, wants to announce that price discrimination among customers takes place. It is clear enough when a Latin American bureaucrat says, "We just sold coffee at $1,675 a pound." If he says, "We just traded 600,000 pounds of coffee for 1,380,000 pounds of copper," the true price of both coffee and copper are hard to determine.

• Western marketing skills and channels are utilized. Neither the socialist states nor the developing countries have established the marketing capacity to move the quantity of goods they are able to produce. Through barter and compensation arrangements these countries have relinquished the selling function to others. Even the best bureaucrats in most countries have only a rudimentary understanding of how goods are marketed in the West. I recall a conversation with a Soviet purchasing officer who specialized in buying from American suppliers in which he said he had never heard of RCA or General Electric. I have no reason not to believe him. It is no wonder American marketing professors are being asked to put on seminars in other countries. Until they learn to sell their products, the nonmarket economies will depend on western marketers.

• The practices exploit western economic problems. This is a condition under which barter and compensation are likely to occur, not a reason for them occurring. Westerners usually enter into such

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